

Message Text

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PAGE 01 STATE 054870
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C O N F I D E N T I A L STATE 054870

FOR THE AMBASSADOR

E.O. 11652:GDS

TAGS: ENRG, CA

SUBJECT: NORTHERN GAS PIPELINE

1. FOLLOWING MEMO AND LETTER SENT AT REQUEST OF DEPT OF
ENERGY PIPELINE COORDINATOR ADGER FOR YOUR INFORMATION
IN SUPPORT OF CURRENT DISCUSSIONS WITH GOC ON PIPELINE
DIMENSIONS AND COSTS.

2. BEGIN TEXT

MARCH 1, 1978
MEMORANDUM TO: COMMISSIONER SMITH
FROM: JOHN B. ADGER
SUBJECT: CALGARY MEETING ON 56-INCH SYSTEM COST ESTIMATES

YOU WILL REMEMBER THAT WHEN THE CANADIANS' DECISION WAS
ISSUED REGARDING THE PIPE SIZE QUESTION, THEIR CAPITAL COST
CONFIDENTIAL

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PAGE 02 STATE 054870

ESTIMATE FOR THE 56-INCH SYSTEM WAS \$4413 MILLION, OR \$179
MILLION HIGHER THAN THE ESTIMATE GIVEN IN ANNEX III OF THE
AGREEMENT FOR THE 54-INCH SYSTEM. OUR ESTIMATE FOR THAT
DIFFERENCE WAS \$58 MILLION.

WHEN WE ARRIVED IN CALGARY, WE WERE INFORMED THAT COSTS
FOR THE 56-INCH SYSTEM HAD BEEN RE-ESTIMATED, AND THE TOTAL

WHICH CORRESPONDED TO THE FIGURES IN ANNEX III WAS \$4328 MILLION, OR \$94 MILLION MORE THAN THE ANNEX III FIGURES FOR THE 54-INCH SYSTEM. THE ATTACHED LETTER FROM RON RUTHERFORD TO GEOFF EDGE EXPLAINS THE REASONS FOR THE REVISION.

THERE THEN ENSUED A PERIOD OF DISCUSSIONS ABOUT WHY OUR NUMBER WAS \$58 MILLION AND THEIRS WAS \$94 MILLION. DURING THAT DISCUSSION A SECOND HANDOUT (ATTACHMENT 2) WAS DISTRIBUTED WHICH COMPARED FOOTHILLS' CONSTANT DOLLAR ESTIMATES TO OURS. WHEN WE FOCUSED ON COMPARISON OF THE 56-INCH ESTIMATES TO THE 54-INCH, IT BECAME CLEAR SOMETHING WAS WRONG: ESSLEY'S \$35.0 MILLION IN 1976 DOLLARS ESCALATES TO THE \$58 MILLION IN CURRENT DOLLARS WHEN INFLATION AND AFUDC ARE FACTORED IN; HOWEVER, FOOTHILLS' \$30.3 MILLION IN 1976 DOLLARS WOULD NOT ESCALATE TO ANYWHERE NEAR THEIR \$94 MILLION CURRENT DOLLAR NUMBER.

AT THAT POINT THE FOOTHILLS SIDE "CONFESSED": THE \$94 MILLION ESTIMATE CONTAINED \$38 MILLION TO CORRECT A MISTAKE THEY HAD MADE IN ALL THE NUMBERS IN ANNEX III TO THE AGREEMENT. THEIR ESTIMATE FOR ONLY THE DIFFERENCE BETWEEN THE 54-INCH AND 56-INCH SYSTEMS WAS \$56 MILLION, AS COMPARED TO OUR \$58 MILLION.

CONFIDENTIAL

CONFIDENTIAL

PAGE 03 STATE 054870

GEOFF EDGE THEN HELD A ONE-SIDED CONVERSATION WITH RON RUTHERFORD ABOUT WHETHER OR NOT IT WAS FAIR TO CORRECT THE ERROR WHEN THE CANADIAN SIDE HAD AGREED TO THE 48-INCH AND 54-INCH FIGURES IN ANNEX III, MISTAKE OR NO MISTAKE, AND WHAT WAS CALLED FOR HERE WAS AN ESTIMATE FOR THE 56-INCH SYSTEM WHICH WAS COMPARABLE TO THOSE IN ANNEX III. GEOFF THEN ASKED US IF THE U.S. SIDE WAS PREPARED TO ACCEPT THE \$56 MILLION DIFFERENCE (\$94 MILLION MINUS \$38 MILLION) BETWEEN THE 54-INCH AND 56-INCH SYSTEMS. WE SAID YES AND LEFT THE ROOM TO CALL YOU TO CONFIRM.

WHILE WE WERE OUT OF THE ROOM, THE FOOTHILLS PEOPLE WORKED GEOFF OVER (VERBALLY) PRETTY THOROUGHLY ABOUT NOT LETTING THEM CORRECT THEIR EARLIER MISTAKE. AS YOU CAN SEE FROM RUTHERFORD'S LETTER TO EDGE, FOOTHILLS ONLY RELUCTANTLY REVISED THEIR 56-INCH NUMBER DOWNWARD IN THE FIRST PLACE, EXCEPT FOR THE ADMITTED SMALL DUPLICATION. THE \$4328 MILLION FIGURE WAS A VERY CAREFUL RE-ESTIMATE ON THEIR PART (WHICH IS HOW THEY FOUND THE MISTAKE IN THE ANNEX III NUMBERS), AND WAS THE ONLY ESTIMATE WHICH THEY HAD BEEN AUTHORIZED BY THEIR BOARD OF DIRECTORS TO ACCEPT.

GEOFF THEN CALLED JACK STABBACK AND EXPLAINED TO HIM BOTH THE SITUATION AND FOOTHILLS' POSITION. JACK'S REACTION

WAS TO BE CONCERNED ABOUT THE POLITICS OF NOT SIDING WITH FOOTHILLS ON THIS POINT, AND BOTH HE AND GEOFF EXPECTED ALAN MACEACHEN'S POSITION TO BE THE SAME. THAT WAS WHERE THE MATTER STOOD WHEN WE LEFT.

I THINK WE SHOULD TRADE ACCEPTANCE OF FOOTHILLS' NUMBER FOR A CLEAR INDICATION THAT IT INCLUDES THE MONITORING COSTS TO BE PAID TO THE CANADIAN GOVERNMENT. ALAN MACEACHEN'S STATEMENT THAT THOSE COSTS SHOULD BE LESS THAN \$40 MILLION MEANS THAT INCLUSION MAKES FOOTHILLS' EXTRA \$38 MILLION JUST COVER THE MONITORING COSTS. WE ALSO
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 STATE 054870

BELIEVE THERE IS ENOUGH "FAT" IN FOOTHILLS' ESTIMATES TO COVER THIS EXTRA ITEM. REFERRING TO ATTACHMENT 2, NOTICE THAT THE TWO ESTIMATES (FOOTHILLS' AND FERC'S) FOR 56-INCH OVER 54-INCH, AND 56-INCH OVER 48-INCH ARE PRETTY CLOSE: \$30.3 MILLION VS. \$35.0 MILLION, AND \$233.0 MILLION VS. \$219.7 MILLION. HOWEVER, THE TOTALS FOR 54-INCH AND 56-INCH, AND THE COMPARISON OF 54-INCH TO 48-INCH, DIFFER BY MORE THAN \$100 MILLION. ESSLEY SAYS HE CAN ACCOUNT FOR MAYBE \$40 MILLION OF THAT DIFFERENCE, BUT THE REST HAS TO BE CONSIDERED "FAT." LET ME HASTEN TO POINT OUT THAT THIS "FAT" WOULD BE CONSIDERED JUSTIFIABLE ON THE CANADIAN SIDE; IT INCLUDES THINGS LIKE USING THE MOST EXPENSIVE MODE OF TRANSPORTATION IN THEIR ESTIMATE OF THE COST TO MOVE PIPE TO THE JOB SITE, IN ORDER TO MAKE SURE THAT COST IS ADEQUATELY COVERED. "FAT" IS PROBABLY NOT AS ACCURATE AS, SAY, "MARGIN OF COMFORT."

I WENT OVER THIS GROUND YESTERDAY WITH JIM PLACKE IN OUR EMBASSY IN OTTAWA. HE SEEMED TO AGREE WITH MY ASSESSMENTS AND RECOMMENDED DIRECTION, AND SAID HE WOULD HAVE TOMORROWERS CALL US THIS AFTERNOON (WEDNESDAY) TO DISCUSS IT.
END TEXT.

3. BEGIN TEXT

FEBRUARY 27, 1978

(TO) MR. C. G. EDGE
ASSOCIATE VICE CHAIRMAN
NATIONAL ENERGY BOARD
473 ALBERT STREET
OTTAWA, ONTARIO K1A 0E5

CONFIDENTIAL

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PAGE 05 STATE 054870

DEAR MR. EDGE:

RE: CAPITAL COST ESTIMATE 56-INCH DIAMETER SYSTEM

FURTHER TO MY LETTER OF FEBRUARY 14, 1978, I HAVE ATTACHED HERETO A REVISED CAPITAL COST ESTIMATE OF THE SECTION OF THE ALASKA HIGHWAY PIPELINE IN CANADA, IF THE SEGMENT BETWEEN WHITEHORSE AND CAROLINE WERE 56" - 0.54" WALL PIPE TO OPERATE AT 1080 LBS. OUR REVISED ESTIMATE TOTALS \$4,328 MILLION, IN ESCALATED DOLLARS, AS COMPARED TO THE \$4,413 MILLION FORWARDED WITH MY LETTER OF FEBRUARY 14TH.

THE PRIMARY REASON FOR THE REDUCTION IN OUR ESTIMATE IS THAT ON RE-EXAMINATION WE ASCERTAINED THAT THE CONSTRUCTION SCHEDULE FOR THE 56" HAD BEEN EXTENDED OVER A LONGER PERIOD THAN THAT FOR THE 48" AND 54" SYSTEMS. THIS RESULTED IN A HIGHER ALLOWANCES FOR INTEREST DURING CONSTRUCTION (AFUDC). IN THIS NEW ESTIMATE WE SHORTENED THE CONSTRUCTION SCHEDULE TO COMPLY WITH THE RESTRICTIONS IN THE NATIONAL ENERGY BOARD RECOMMENDATION. IN ADDITION, WE DISCOVERED THAT THERE HAD BEEN A DUPLICATION OF SOME OTHER MINOR COSTS, MOSTLY PERTAINING TO LOGISTICS AND SUPPORT FACILITIES, WHICH HAD THE EFFECT OF OVERSTATING OUR 1976 DOLLAR ESTIMATE BY \$14.4 MILLION. THIS HAS BEEN REMOVED IN THIS REVISED ESTIMATE.

MY REMARKS IN THE THIRD, FOURTH AND FIFTH PARAGRAPHS OF MY LETTER OF FEBRUARY 14TH STILL APPLY TO THIS ESTIMATE.

YOURS VERY TRULY,

R.M. RUTHERFORD
EXECUTIVE VICE PRESIDENT
FOOTHILLS PIPE LINES (YUKON) LTD.

ENCLOSURE1:
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PAGE 06 STATE 054870

ESTIMATED CAPITAL COST FOR THE PIPELINE IN CANADA

---	56" DIA. X 0.540" WT.
---	1080 PSI
---	\$ MILLIONS
---	(CANADIAN)

ZONE 1	ALASKA/YUKON BORDER - WHITEHORSE	707
ZONE 2	WHITEHORSE - WATSON LAKE	790
ZONE 3	WATSON LAKE - FT. NELSON	879
ZONE 4	FT. NELSON - ALBERTA/B.C. BORDER	430
ZONE 5	ALBERTA/B.C. BORDER - CAROLINE	872
ZONE 6	CAROLINE - EMPRESS	236
ZONE 7	CAROLINE - COLEMAN	126
ZONE 8	COLEMAN - KINGSGATE	83
ZONE 9	EMPRESS - MONCHY	205

TOTAL 4,328

ENCLOSURE 2:

1876 \$ CAPITAL COST COMPARISON

WHITEHORSE TO CAROLINE

2.4 BCFD

SYSTEM		FOOTHILLS	FERC
48"/1260	\$MM	1,555.3	1,555.3
---	\$/MILE	1,434,000	1,434,000

54"/1120	\$MM	1,758.3	1,650.0
---	\$/MILE	1,621,000	1,521,000

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PAGE 07 STATE 054870

54" OVER 48"	\$MM	203.0	94.7
---	\$/MILE	187,000	87,000

56"/1080	\$MM	1,788.3	1,685.0
---	\$/MILE	1,648,000	1,553,000

56" OVER 54"	\$MM	30.3	35.0
---	\$/MILE	27,000	32,000

56" OVER 48"	\$MM	233.0	219.7
---	\$/MILE	214,000	119,000

END TEXT. CHRISTOPHER

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